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GUIDELINES TO INTERNATIONAL CONTRACTS FOR THE ACQUISITION, ASSEMBLY AND MANUFACTURE OF AGRICULTURAL MACHINERY AND SPARE PARTS THEREFOR *

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These Guidelines have been prepared pursuant to the recommendation of the Second Cosultation on the Agricultural Machinery Industry (Number 17) that UNIDO prepare Guidelines to contracts for the import, assembly and manufacture of agricultural machinery and training taking due account of the documentation considered by that Consultation and the views expressed on it, other relevant national and international documents, views expressed to the UNIDO secretariat by participants of the Consultation and other interested parties and the experience gained in work on contractual arrangements within the framework of the UNIDO System of Consultations.

The purpose of these Guidelines is to outline the clauses in the contracts leading to the manufacture of agricultural machinery which are of particular concern to the purchaser of agricultural goods or the transferee of manufacturing technology from a developing country. The aim of these Guidelines is to assist purchasers of agricultural machinery and industrial works for the manufacture of agricultural equipment from developing countries in their initial negotiations with suppliers by directing such purchasers' attention to some of the items to be provided for in the relevant contracts. This document is intended to supply background information only, furnishing signposts to the more controversial provisions of the contracts under consideration and not detailed descriptions. More particularily, these Guidelines deal with only some of the clauses usually contained in the contracts in question and do not deal with matters more frequently considered by a purchaser's legal advisor rather than by the purchaser him/herself. For a more comprehensive treatment of these contracts, prospective purchasers should look to the documents referred to in the text of these Guidelines.

PART I

THE CONTRACTS UNDER REVIEW

1. Typically, a purchaser's first introduction to a product which he/she may later decide to manufacture is his/her acquisition of it for his/her own use or for re-sale. A purchaser of a factory for the production of agricultural machinery will frequently have had a contract for the acquisition of the same or similar equipment as that which he/she wishes to manufacture. If that first contract was successful - if the equipment was widely sold in the purchaser's country - the purchaser may have gone on to acquire a stock of spare parts for the machinery to enable him/her to repair it. The commencement of the trade in spare parts was, almost certainly, denoted by a contract for their supply to the purchaser. Through his/her business in the sale of machinery and spare parts the purchaser will have become aware of the high costs involved in the importation of agricultural machinery and may decide to build a factory for the assembly or manufacture of that equipment in his/her own country.

2. The elements involved in the construction of industrial works include the engagement of an architect/engineer to design the factory, the erection of buildings, the acquistion of production equipment and its installation and, perhaps, the employment of a consultant to put the works into efficient operation. In addition, a purchaser from a developing country, indeed, any novice to the manufacture of agricultural equipment, may need to acquire the know-how of the technology involved. Should the purchaser desire to produce particular machinery he/she will have to enter a licensing agreement with the original manufacturer of that equipment to permit him/her to use certain patents and trademarks.

3. The various steps described, culminating in the purchaser's assembly or manufacture of agricultural machinery, are each characterized by a contract. These Guidelines consider a number of these contracts marking the stages leading to the assembly or manufacture of agricultural machinery which are likely to have an international basis. The contractual relations considered are between:

(i) a purchaser and a supplier of agricultural machinery;
(ii) a purchaser and a supplier of spare parts for that machinery;
(iii) a purchaser and an architect/engineer for the design of a factory and the supervision of its construction;
(iv) a purchaser and a supplier of production equipment;
(v) a purchaser and an operations manager for the initial management of the factory;
(vi) a purchaser and a transferor of the manufacturing know-how and of industrial property rights (patents and trademarks).

As the contracts for the acquisition of land upon which to build the works, for the erection of buildings to house the production equipment and for the servicing of the works (water, roads etc.) are national in character, these are not considered in these Guidelines. Neither is the question of the training of personnel to operate a factory dealt with in these Guidelines. For a description of the terms and conditions which can be included in a contract between a purchaser and an instructor in industrial and technical methods the reader should consult "Legal Aspects of Industrial Training", UNIDO, 1981.

CONTRACTUAL FORMS

4. The contract form used to obtain a supply of machinery and of spare parts is quite standard - it is the content of the clauses which varies from contract to contract.

5. This is not the case in the construction of a factory where a great variety of skills and materials are required. Broadly speaking, there are three contractual forms now commonly used to achieve the establishment of industrial works: the turnkey contract, the comprehensive contract and a series of separate contracts with different suppliers.

(i) The expression "**turnkey**" describes the form of contract used when a purchaser employs one supplier to deliver fully constructed, operational works. That one supplier is responsible for all phases of the construction, including its timely completion and efficient operation. A **semi-turnkey** contract is one in which the supplier, although not undertaking the entire construction, is responsible for putting the works into operation as is the turnkey supplier.

(ii) A "**comprehensive contract**" is one in which the supplier undertakes both the building and civil engineering work and the supply and erection of the industrial plant and assumes responsibility for the works and services as a whole. Comprehensive contracts are sometimes concluded with a **joint venture**, that is to say, with a group of suppliers acting as one single contracting body to the purchaser.

(iii) Under the "**separate contracts**" formula, the purchaser employs a number of suppliers to provide the various services and materials required for the construction of the factory. Each supplier is only liable to the purchaser for the specific equipment, materials and services which he/she is engaged to provide.

6. A consideration of the different tasks involved in the construction of a factory for the assembly or manufacture of agricultural machinery will reveal that a major feature is the co-ordination of the various elements. In this context time is money; delay in one aspect of the work will have a domino effect and may require the payment by the purchaser of penalties/liquidated damages to a supplier who has been delayed in his/her performance of his/her contractual obligations by some other supplier's failure to adhere to the time schedule. Furthermore, the different elements brought together and merged in the construction of works makes it difficult to establish which of a number of suppliers involved is responsible for a defect becoming apparent later. In construction contracts, therefore, the party in overall control bears two substantial risks - the hazards of delay and the danger that defects will not be ascribable to individual suppliers.

7. If a purchaser employs one supplier to deliver a completed factory - by way of turnkey or comprehensive contract - the supplier assumes responsibility for the co-ordination of the various elements in the construction and he/she is liable for any delay. Under a turnkey contract, the supplier is liable for any defect in the works whether or not that defect arises from the supplier's own work or that assigned by him/her to a sub-contractor.

A supplier under a semi-turnkey or comprehensive contract is liable to the purchaser for those defects which occur in that part of the works undertaken by him/her. But if the purchaser acquires the skills, materials and equipment necessary for the construction of the factory from different sources under separate contracts, he/she is responsible for the co-ordination of the various elements of the construction although, as will be seen, he/she can discount this risk in the engagement of a professional manager to supervise and co-ordinate operations. The greater the number of suppliers involved, the more difficult it becomes to ascribe a particular facet of the work, and hence a particular defect, to the services or materials provided by an individual supplier. The purchaser must bear the financial consequences of defects in the works if it proves impossible to establish the specific responsibility of a particular supplier out of a number engaged in the construction of the works.

8. As is apparent, the risks undertaken by a turnkey supplier and, to a lesser extent, by a comprehensive contractor, are substantial. The carriage of these risks inevitably inflates the purchase price payable to such suppliers. The price is also greater where turnkey or comprehensive contracts are used because the price includes what would, if specified, be called commissions on the procurement by the supplier of services and materials from third parties.

9. An analysis of the relative merits of the possible contractual forms which can be used is not within the scope of these Guidelines (rather, see "Guide on Drawing Up Contracts for Large Industrial Works" ECE/Trade/117 and UNCITRAL document A/CN.9/WG.V/WP.15/Add.8, "Choice of Contracting Approach"). Suffice it to say that there are many circumstances (see paragraph 10 below) which render the employment of different suppliers under separate contracts the optimum means for particular purchasers to construct a factory. These Guidelines presuppose that the purchaser has chosen to use the latter contract form.

SEPARATE CONTRACTS APPROACH

10. The principal benefit in using the contractual form of a series of contracts is the lesser cost commensurate with the purchaser undertaking the risks mentioned. There are other benefits; the purchaser is not tied to buying only the materials and equipment which one supplier can provide, he/she can purchase different items from a variety of suppliers; the purchaser can maximize his/her employment of local contractors thus effecting a saving in foreign exchange and a development of local skills; the purchser can learn from his/her greater involvement in the construction of the works, inter alia, he/she can acquire information about the original sources of materials and equipment enabling him/her to deal directly with the source suppliers in the future.

11. The tasks involved in the construction of a factory are outlined in paragraph 2 above. These elements in the construction of works can each be supplied by different parties or the suppliers can be engaged to carry out several services each, e.g. the supplier of plant may also be engaged to carry out its installation, indeed, he/she may also grant the purchaser a patent licence.

12. The risks inherent in the co-ordination of the various elements of work in the construction of a factory, borne by the purchaser under the separate contracts form, can be discounted to some extent by the employment of a professional construction manager. It is now quite common for industrial architects/engineers to provide services which cover both the initial, design stages of the project and the co-ordination and supervision of construction. A construction manager, be he/she the designer of the works or not, can be engaged not merely to advise the purchaser during construction but also to plan and schedule, to draft tender documents, to negotiate and conclude contracts with suppliers, to test materials and equipment and to supervise and co-ordinate the construction. Unless the purchaser has engineering knowledge and construction experience it will be necessary for him/her to employ a construction manager.

13. Although his/her liability to the purchaser can be considerable, depending on the functions alotted to him/her under the contract between the purchaser and the construction manager, the latter does not take on all the responsibilities of a turnkey contractor as regards suppliers' delays and defects in the works. The distinction between the two is demonstrated by the fact that in contracting with suppliers, the construction manager does so on behalf of the purchaser while the turnkey contractor does so on his/her own behalf thus remaining liable to the purchaser for his/her sub-contractor's work.

GENERAL CONSIDERATIONS IN THE DRAWING OF CONTRACTS

14. A satisfactory contract is one which sets out clearly the objectives being pursued by the purchaser and the supplier, accurately reflects the parties' agreement, clearly defines their respective rights and obligations and facilitates the settlement of any disputes which may arise.

15. The more precise and clear the words of a contract are, the less likely are later disagreements. In the process of negotiating towards a precisely worded contract the parties' ideas are clarified and their commitments brought home to them. It is necessary for the parties to a contract to draw it up with utmost care so as to make clear their respective rights and obligations.

16. However, this drive towards precision may of itself give rise to difficulties. In drafting a contract the parties - particularily when they are attempting to be specific - tend to deal only with those areas of primary or immediate concern thus failing to provide for matters which may become important in the implementation of the contract. It is a general practice in the interpretation of contracts that where detailed clauses and expressions are employed, the absence of a specific provision is assumed to be a deliberate exclusion. To ensure that there are no lacunae in the contract, provisions of more general application should be coupled with more specific ones (see paragraph 34 below for an example). In order to give effect to that general provision the more detailed clauses or expressions should be stated to be indicative rather than exhaustive.

17. Contracts between compatriots are negotiated and concluded against a background of national law known to both parties. Many matters are not specifically dealt with in such contracts, the parties being content to allow the importation to the contract of their country's law.

This is not the position in international contracts. Very often, the applicable law or Courts with juristiction over the parties will not be completely certain. Furthermore, one party may resist the application of the entire legal system of the other party's country to the contract. Indeed, a national code may not provide for the regulation of international contractual relations. Thus it is that international contracts provide in detail for many matters often not mentioned in national contracts. The rights and obligations of the parties are not assumed to be those deemed by a particular national law, rather they are specifically and deliberately set out. This usually applies to all the provisions of the contract, not only those made necessary by the very fact of the contract being an international one, e.g. the specification of the applicable law (see paragraph 68 below). In this context it should be noted that a number of international conventions exist which can be imported to the contract by specific reference - the contract need only mention their application for these to be read into it (as an example see INCOTERMS, International Commercial Terms).

18. Where an enterprise involves the conclusion of a number of contracts with different suppliers the purchaser must ensure that the contracts are compatible. This is of particular importance in the clauses dealing with the consequences of the supplier's delay (see paragraph 23 below). Where the purchaser employs the separate contracts approach he/she must ensure that in the event of non-performance or delay on the part of any of the suppliers that the latter will compensate him/her sufficiently to enable the purchaser to discharge any financial obligations he/she may have incurred towards the other suppliers arising out of the first supplier's delay or failure in performance. Each of the contracts should make specific reference to it being one of a number of contracts for the creation of an enterprise and state its dependance on the other contracts. (This item can be included in the recitals mentioned at paragraph 54 below).

19. Lawyers the world over use precedents, forms or models in drawing contracts. While, of course, they change many of the provisions of the clauses used in such precedents, these act both as a source of ideas as to the eventual content of the contract in question and as a checklist to ensure that all aspects are provided for in the contract. A purchaser will find it useful to puruse a number of these precedents, forms and models as they will stimulate his/her ideas as to how to deal with the various aspects of his/her contractual relations with the supplier. But, caveat emptor. These precedents, forms and models, often published by suppliers, must not mesmerize the purchaser leading him/her to believe that the provisions in such precedents are immutable. Rather, the purchaser should have it foremost in mind that a contract's principal purpose is to reflect the agreement of the parties - the agreement comes first and its negotiation should not be dictated to by these forms and precedents.

20. In some countries there exists legislation governing certain aspects of contractual relations. This is particularily the case in respect of contracts for the transfer of technology. For instance, in some countries anti-monopoly (anti-trust) legislation limits the length of time for which a purchaser can be bound to buy goods from a supplier. Thus a purchaser negotiating with a supplier should agree the terms of the proposed contract in principle only and should make the agreement subject to confirmation that the suggested terms do not infringe any national or international law applicable to the contract.

PART II

This Part seeks to sketch the more controversial clauses particular to the contracts under review. There are certain clauses which are virtually standard in international contracts and which are not specifically referable to the subject matter of the agreement. These last are considered in outline in Part III of these Guidelines.

A. CONTRACT FOR THE SUPPLY OF AGRICULTURAL MACHINERY

21. Quality and Suitablility

(a) A purchaser from a developing country may not have available locally the information necessary to enable him/her to judge the quality of the agricultural machinery which he/she proposes to buy. In addition, a novice in the acquisition of that machinery, who has little or no national technical expertise to draw upon, cannot know what particular machinery will best suit the soil and other conditions prevailing in his/her country.

(b) There are two approaches which the purchaser can adopt in seeking to ensure the suitability and quality of the equipment: the purchaser can require the testing of the machinery before purchasing it or he/she can rely on the supplier's representations. These courses of action are not mutually exclusive, a blend of both can be included in the contract. However, as will be seen, the testing of the equipment may water down the effect of the supplier's representations. There are advantages and disadvantages to whichever approach is principally emphasized in the contract.

(c) Under a number of legal systems a purchaser's reliance on representations made by a supplier will render the supplier liable should any of these prove false. The enforcement of that liability can, of course, contain difficulties in the question of proof and will, most likely, be subject to the delays and other drawbacks occasioned by Court proceedings. On the other hand, where machinery is tested for suitability or quality, either by the purchaser or an independent expert, the purchaser risks it being deemed that he/she did not rely on the supplier's statements. Furthermore, if the purchaser is not sufficiently skilled or experienced to test the machinery, he/she may need to have these trials carried out by an independent expert. The latter testing will undoubtedly increase the purchase price. The purchaser must weigh up the relative merits of the two approaches; the benefit of an early disclosure in tests of defects and of the unsuitability of the equipment against the consequent increase in cost and the possibility of being left with no remedy should the trials fail to uncover defects or the unfitness of the machinery to local conditions. The purchaser can require the inclusion in the contract of an amalgam of these approaches, e.g. the contract can be made conditional upon the supplier testing the equipment in the purchaser's country and achieving certain results.

(d) If the purchaser is relying on the supplier's representations to aid him/her in his/her choice of machinery, then this must be reflected in the contract by the inclusion of a reference to the purchaser's express dependance on the supplier's statements. Whether or not the purchaser decides to employ the testing approach to check on the suitability or quality of the machinery, the representations of the supplier should be assimilated into the contract as warranties or conditions. (In this context it must be noted that under some legal systems the breach of a **condition** of a contract permits the injured party to rescind the contract while most legal systems require the offending party to pay compensation for a breach of **warranty**.) The Final Act of the United Nations Conference on Contracts for the International Sale of Goods deems certain representations implicit in every contract to which it applies.

The provisions of this Final Act can be specifically imported to the contract as the "general provision" referred to in paragraph 16 above by the agreement of the parties (see also paragraph 17) and more specific representations particularized, e.g. that the machinery will suit the purchaser's local conditions. (See also paragraph 26 below).

(e) The question of the suitability of machinery to local conditions is one of particular concern to a purchaser from a developing country. In order to make certain that this matter is adequately dealt with in the contract the issue of suitability and the issue of quality should be the subject of separate clauses.

22. After Sales Service

(a) Purchasers in developed countries often have as an incentive to purchase substitute equipment the tax advantages of such a replacement. Furthermore, the sophisticated consumer market in the developed world allows a ready acceptance of the concept of obsolescence. This is far from the case in developing countries where tax advantages are, for the most part, a thing of the future and machinery must be made to work for and beyond its natural life. An after-sales service is therefore of greater importance to a purchaser from a developing country.

(b) The method principally used in contracts to ensure a minimum after sales service and the freedom of the goods from defects is that of a guarantee. In this context a **guarantee** is a promise to make good - by replacement or repair - any defects in goods which are not due to factors beyond the supplier's control, e.g. misuse by the purchaser. Guarantees are limited in time. The purchaser should seek to obtain as long a guarantee period as possible - this period can be measured in time or in hours-use of the machinery. Furthermore, the contract can be made to provide for a new guarantee period to run on equipment repaired or replaced under the guarantee. Time limits must be set within which any faults will be corrected to ensure that the machinery does not lie idle for long. Many contracts provide that where the supplier fails to perform his/her obligations under the guarantee that the purchaser will be entitled to repair the goods at the risk and cost of the supplier. Given the circumstances of a purchaser from a developing country, **inter alia**, the fact that he/she will, most likely, have no back-up equipment, such a purchaser should consider providing in the contract a sanction against non-performance of the guarantee, e.g. the payment of liquidated damages by the supplier (see paragraph 23 below).

(c) Unless the contract provides otherwise, once the guarantee period has expired the supplier's only remaining liability is in respect breach of contract and, under certain legal systems, of what are called **"latent defects"**. These are defects so fundamental that, although they fall outside the terms of the guarantee, national laws require the supplier to rectify them. For the reasons explained at paragraph 17 above the purchaser should ensure that the contract specifically provides for the rectification of latent defects. In addition, the purchaser may wish to have the contract provide for the repair and maintenance of the machinery by the supplier on the expiry of the guarantee period - such services will, of course, have to be paid for by the purchaser.

23. Delivery

(a) Experience and adequate financing enable purchasers from developed countries to anticipate their purchase requirements. These purchasers' ease in planning permits them to build into their acquisition's schedule a tolerance for delay. This is not the case for purchasers from developing countries. Accordingly, the supplier to the latter purchasers must be in a position to assure the delivery of agricultural machinery within certain time limits.

(b) A failure in the due delivery may have a series of grave consequences for a purchaser from a developing country. Monetary compensation - of whatever magnitude - may not be sufficient to make good the damage which can result from such tardiness. But, the prospect of having to pay compensation can, of itself, be an inducement to the supplier to adhere to delivery schedules.

(c) Two standards of compensation are generally used in contracts, damages and liquidated damages (or penalties). The word **"damages"** refers to those monies required to compensate a person for an injury done to him/her. Simple damages are calculated after the breach of contract (be it a breach of the delivery schedule or a breach of warranty), bear a direct relationship to the loss suffered by the injured party and are usually limited to compensating the loss which was forseeable by the supplier. **Liquidated damages**, on the other hand, represent compensation estimated before the damage arises, that is to say, in the contract - usually calculable at a daily, weekly or monthly rate - and payable on the occurrance of some breach of contract without, necessarily, an investigation of the injured party's loss and, often, without proof of the offending party's culpability. (A **penalty**, which is not recoverable under some legal systems and, therefore, should not be employed as a sanction unless all the possible legal systems applicable to the contract permit its enforcement, is in the nature of a fine and does not represent a genuine pre-estimation of an injured party's loss as do liquidated damages.)

(d) The advantage of liquidated damages to the injured party is that the party in default becomes immediately liable to pay them - there is no delay while loss is established. The very immediacy of liquidated damages tends to stimulate compliance with the contract. The disadvantage of liquidated damages lies in the fact that the amount of the compensation is fixed at the outset and cannot be revised when the damage actually occurs. This is a clear drawback as it is not usually possible to determine in advance the loss which may result from a party's breach of contract. Furthermore, as liquidated damages are usually payable whether or not the loss they are meant to compensate actually occurs, they are invevitably fixed at a lower amount then would be payable as damages if a forseeable loss were to be sustained. There are circumstances in which liquidated damages will only compensate a fraction of the loss suffered. Conversely, the advantage of damages is that they compensate the loss actually sustained to the extent to which it was forseeable by the defaulting party. The disadvantage of damages is the considerable delay there may be in their award - a delay caused by the Court's necessary intervention to investigate liability and evaluate the damages payable. The fact of legnthy Court proceedings may make the damages irrelevant by the time they are recovered, e.g. where a purchaser has been unable to manufacture by reason of a supplier's non-delivery of some small but essential part. (See also UNCITRAL document A/CN.9/WG.V/WP 11/Add. 4 on the topic "Damages").

(e) The purchaser must, in the light of his/her own circumstances, determine which form of compensation is most suitable to him/her should the supplier be in breach of contract. In the case of delivery, the method now most commonly employed to seek to ensure that there will be no delays is for contracts to provide for the payment of liquidated damages in the event of the supplier's delay. If due delivery is essential to the purchaser, then the approach to be favoured is, perhaps, that of liquidated damages rather than damages as this method is more likely to induce the supplier to make delivery on time even if, in the event, liquidated damages do not properly compensate the purchaser.

(f) The amount fixed as liquidated damages, if this approach is used, should be a genuine pre-estimate of the purchaser's likely loss taking all circumstances into account. The higher the liquidated damages, the more likely these are to motivate the supplier to deliver the machinery promptly.

(g) There are, of course, aspects of delivery other than delay which are of particular concern to a purchaser from a developing country. If machinery is delivered in a completely knocked down form then the purchaser will, most likely, require the supplier to supervise the assembly of the equipment. It is useful to require that the supplier use local employees in this assembly work as this will give the latter an opportunity of familiarizing themselves with the machinery. If the country of delivery does not have good port, road and freight facilities, the contract should provide for the adequate packing of the equipment to meet these local conditions. Furthermore, the purchaser must ensure that the contract provides that each item of equipment be accompanied by all the necessary technical documentation and tools.

B. CONTRACT FOR THE SUPPLY OF SPARE PARTS FOR AGRICULTURAL MACHINERY

24. Stock Management

A purchaser from a developing country commencing a trade in spare parts for agricultural machinery has not the quantity or quality of information available to him/her as his/her counterpart in the developed world; the latter can easily obtain nationally supplied training and the relevant machinery sales information. The purchaser from a developing country may be able to acquire the necessary skills and information only from the supplier. The latter is in the best position to know the quantity of machinery present in the purchaser's country which requires the spare parts in question and, further, is aware of those parts most frequently replaced. Accordingly, a contract for the supply of spare parts to a purchaser from a developing country should require the supplier to assist in the initial management of stock. One method which can be employed is to have the contract provide that the initial stock requirements be estimated by the supplier and that, for a period at least, the supplier will accept a return of surplus stock crediting or paying the purchaser the cost of such returned spare parts. (As regards the transfer of information see paragraph 30 below).

25. Technical Information

Where the supplier of spare parts is also the supplier of the agricultural machinery the purchaser should require the supplier to provide him/her with a list of the components of such equipment. As the purchaser's trade in spare parts will necessitate his/her complete understanding of the machinery and its components the contract should also require the supplier to furnish the purchaser with all the documentation, including diagrams and instructions for repair and maintenance, relevant to the equipment.

26. Quality

The remarks made in paragraph 21 above about the quality of agricultural machinery to be supplied are equally applicable to spare parts save to this extent: In practice it is unfeasible to apply the approach of having the parts independently tested as can be done in the case of machinery. The purchaser is usually compelled to rely on the supplier's own quality controls. As has already been said, the supplier's representations should be specified in the contract - from the most obvious, e.g. that the parts are fit for the purposes required of them by the purchaser, to the most specific, e.g. that they will be capable of x hours' use.

27. Delivery

Again as regards delivery much of what has been said about the delivery of agricultural machinery (paragraph 30 above) is relevant to spare parts. However, where in respect of machinery the purchaser has the option of making provision in the contract for the payment of damages or liquidated damages (or penalties, as the case may be) on the breach of the delivery schedule, the very frequency of the transactions in contracts for the supply of spare parts makes liquidated damages (or penalties) a more suitable remedy for delays in delivery.

28. Price

The nature of trade in spare parts is such that a change of supplier usually leads to an upheaval in the purchaser's business (but see paragraph 30 below where a phased change-over of supplier is considered). This is more particularily the case when the purchaser, being from a developing country, has not the means to come to know other suppliers. Thus by entering such a contract, indeed, perhaps in entering the original contract for the supply of agricultural machinery, a purchaser from a developing country is binding him/herself to acquiring spare parts from the supplier for a period of years. To counterbalance this commitment by the purchaser it is usual for contracts for the supply of spare parts to provide that the prices of those parts will remain fixed on an annual basis. Another form of consideration given in exchange for the purchaser's commitment is the accordance to the purchaser of the status of "most favoured customer". The grant of such status in a contract usually means that the supplier is obliged to give the purchaser, by way of ammendment of the contract, any more favourable terms or conditions as may be contained in contracts subsequently entered by the supplier with third parties.

29. Duration of the Contract

(a) As has been mentioned, the more sophisticated consumer market in the developed world - abetted by such considerations as the tax advantages in replacing trade machinery - permits a ready acceptance of claims of obsolescence. The fact that this is not the case in the developing world, added to the lack of information and experience referred to, makes continuity of supply a more important consideration to a purchaser from a developing country than it is to his/her counterpart from a developed country. The former must seek to include in the contract a promise by the supplier to supply the purchaser with the spare parts manufactured by him/her for at least a minimum number of years.

(b) In order to provide for the possibility of the supplier ceasing to trade or being reluctant to bind him/herself to the manufacture of a part solely in order to supply this to the purchaser, the contract should contain some flexibility in the supplier's obligation of continuous supply. One means of achieving this necessary malleability in the contract is to include a provision that the supplier will furnish the purchaser with all the documentation and licences necessary to enable the purchaser or some person at his/her behest to manufacture any parts of which the supplier discontinues production. (In respect of those parts supplied but not manufactured by the supplier, see paragraph 30 below). This undertaing by the supplier can be viewed as part of the consideration for the purchaser's commitment mentioned in paragraph 28 above.

30. Sub-Contractors and Original Sources of the Parts

(a) The components of agricultural machinery are not all manufactured by their supplier. Inevitably, a supplier of parts obtained from a third party charges the purchaser a handling fee over and above the cost price. It is therefore in the interests of the purchaser to deal directly with such third parties. In order to do so the purchaser must know who those source suppliers

are and why they were chosen by the supplier. The purchaser must also have available the specifications of those parts to enable him/her to "shop around".

(b) This information is valuable. Furthermore, it is highly confidential and will only be revealed by the supplier when a certain degree of trust has been built up between the parties. One form of "payment" which the purchaser could make for the transfer of this information is to bind him/herself to purchasing all spare parts (including those not produced by the supplier) for a number of years (this is called a **solus agreement**) on the expiry of which the supplier will be required to furnish the purchaser with the information mentioned and after which period the purchaser need only purchase from the supplier those spare parts manufactured by the latter. There are, of course, other methods by which the purchaser can pay for this information. Different means recommend themselves to different circumstances.

C. CONTRACT FOR THE DESIGN AND SUPERVISION OF THE CONSTRUCTION OF WORKS FOR THE ASSEMBLY OR MANUFACTURE OF AGRICULTURAL MACHINERY

31. Scope of Services

(a) As has been explained (see paragraphs 6 and 7 above) the greatest single task in the construction of a factory is the co-ordination of the supply of materials, equipment and services. Where the contractual form of obtaining goods and services from different sources is used by the purchaser, that co-ordination is his/her responsibility. Purchasers who lack experience are well advised to engage a construction manager to supervise and marshal the construction of the works. For the purposes of these Guidelines the rôle of construction manager is deemed to be assumed by an industrial engineer/architect (see paragraph 12 above).

(b) The services which an architect/engineer can provide are wide ranging, they cover the spectrum from counselling services and pre-investment studies, through the design and supervision of the construction of the buildings to house the plant and the installation of the production equipment, to specialist design and development services, including technical assistance. It is not within the competance of these Guidelines to detail the services available from such an engineer/architect. For a description of these prospective purchasers should look to more specialized documents (see, for instance, ECE document "Guide for Drawing Up International Contracts on Consulting Engineering, Including Some Related Aspects of Technical Assistance" Trade/145).

(c) On balance, it is preferable to employ the services of the architect/engineer from at least the design phase. The earlier he/she becomes involved, the more he/she can direct measures which will facilitate the co-ordination of the construction. Thus, the engineer/architect engaged before the contracts with individual suppliers are concluded will be able to provide the purchaser with details of the delivery and performance schedules to be included in those contracts. Indeed, the architect/engineer can be engaged to negotiate and draw the contracts in co-operation with the purchaser's legal advisor.

(d) The services to be performed by the industrial architect/engineer are, of course, a matter for the parties to agree. Certain preparatory work should, however, be done by the purchaser. The latter should obtain information about the construction of works and, on the basis of this, list the tasks which he/she wishes the engineer/architect to carry out. He/she is then in a better position to choose those services which are essential to him/her from amongst those offered by the architect/engineer.

32. Functions

(a) The parties should ensure that the contract sets out the engineer/architect's functions in the various aspects of his/her work clearly. This is of importance because usually an engineer/architect engaged in the construction of works fulfills two capacities, if not three. His/her primary rôle is as agent and advisor to the purchaser in the services he/she is engaged to provide. However, construction contracts usually vest in the engineer/architect quasi-judicial functions requiring impartiality on the engineer/architect's part. These functions can be described as those of a "certifier".

(b) A contract between a purchaser and a supplier of equipment or services for the construction of a factory usually provides that payment will not be made against goods delivered or services rendered until the engineer/architect has certified that the goods or services have been so delivered or rendered in accordance with certain standards of quality. In certifying, the architect/engineer does not act as the purchaser's agent - he/she must act impartially and fairly between the parties and with disinterest. This does not mean that the engineer/architect's function is that of judge between the parties, rather, he/she is required to exercise professional independence in valuing or appraising the work done and materials supplied. Thus the architect/engineer must often act in two capacities in respect of the same matter requiring approval. He/she acting as the purchaser's agent may disapprove of the work or materials but, as a certifier with quasi-judicial functions, will have to decide with impartiality whether or not the work and materials are adequate and ought to be approved.

(c) Occasionally a contract will vest in the engineer/architect a third function, that of arbiter in disputes between the parties. Indeed, while few contracts provide for this latter function to be assumed by the architect/engineer, in practice the parties frequently refer disputes to the engineer/archichitect whose opinion is often accepted by both parties in consequence of their experience of his/her impartiality as certifier (see also paragraph 66 below).

33. Price

(a) The charges made for an architect/engineer's services comprise reimbursement for a variety of expenses - e.g. the salaries of the architect/engineer's employees, the use of equipment, office overheads - and a margin of profit. Charges are usually computed on one of the following basis or by a combination of two or more:

(i) **Time:** This method is based upon the payment to the engineer/ architect of a fee for the time spent by him/her and each category of his/her staff in working for the project - the payment being calculated at hourly, weekly or monthly rates agreed in the contract - plus a reimbursement of the costs directly incurred by the architect/engineer.

(ii) **Payroll cost multiplied by an overhead factor plus direct expenses:** Under this formula the engineer/architect's fee is calculated by multiplying the salaries of the architect/engineer's staff engaged in the project by an overhead factor representing the engineer/architect's profit specified in the contract plus the costs directly incurred by the architect/engineer.

(iii) **Lump Sum:** This manner of payment - by a lump sum agreed in the contract inclusive of the architect/engineer's direct expenses or not, as the case may be - is not favoured by architects/engineers if there is any uncertainty about the time the construction will take.

(iv) **Percentage of the construction cost**: This method of calculating the architect/engineer's fee is usually employed when his/her principle task is that of designing the works and preparing drawings and specifications. The engineer/architect is paid a sum equal to an agreed percentage of the construction cost. The "construction cost" is the total actual or estimated, as may be agreed, cost to the purchaser of the construction of the works. The direct costs of the engineer/architect may be reimburseable or not, depending upon the parties agreement.

(v) **Expenses plus a percentage fee or a fixed fee**: This method is based on the reimbursement to the architect/engineer of the cost of his/her services. The expenses involved usually consist of three factors - the salaries of his/her staff engaged in the work, his/her overheads (office etc.) and out-of-pocket expenses (travel etc.). To the expenses is added a fee calculated either as an agreed percentage of the expenses or in the form of a lump sum.

(vi) **Retainer**: Where the engineer/architect's services are expected to be required only as the occasion demands, it is usual for a purchaser to pay him/her a retainer. The retainer ensures the availability of the engineer/architect. The amount paid by way of retainer varies according to the services of which the purchaser wishes to be assurred. In addition to the retainer, the purchaser must pay the architect/engineer for any services actually rendered on whatever basis is agreed.

(b) The very structure of the methods of calculating the price for the services of an industrial engineer/architect are such that it is difficult to determine the ultimate cost of employing him/her. To enable the purchaser to know as clearly as possible what is involved, the reimburseable expenses, payable in addition, to the "profit" fee, should be detailed in the contract. From these particulars the purchaser may learn means of minimizing the overall price. (See also "Guide for Drawing Up International Contracts on Consulting Engineering, Including Some Related Aspects of Technical Assistance" ECE/Trade/145.)

34. Standards (Quality)

The customary provision in contracts with engineers/architects that the latter will render the services contracted for with all skill, care, deligence and efficiency and in conformity with recognized professional standards should, perhaps, be viewed as a "general" clause (see paragraph 16 above). The purchaser should consider making applicable to the engineer/architect's services in addition the standards of the latter's professional association or those of an international or national body (see paragraph 58 below). (As to a description of the quality of services to be provided by reference to the results to be achieved, see paragraphs 38 and 44 below.)

35. Limitation of Liability

Many contracts between a purchaser and an engineer/architect provide for the limitation of the engineer/architect's financial liability to the purchaser in damages for breach of contract or negligence. Very often the limitation is defined in terms that the maximum compensation which the architect/engineer will become liabile to pay the purchaser is a sum equal to his/her fee or a percentage of it. If the engineer/architect insists on the inclusion of such a limitation, the purchaser should seek to have this set at such an amount as bears some relation to the engineer/architects responsibilities.

D. CONTRACT FOR THE SUPPLY OF PRODUCTION EQUIPMENT FOR THE ASSEMBLY OR MANUFACTURE OF AGRICULTURAL MACHINERY

36. Equipment to be Supplied and Services to be Performed

(a) The contract must, of course, particularize the production equipment to be delivered by the supplier and the installation work to be carried out by him/her. The purchaser may find that certain elements of the equipment are available in his/her own country and may desire to purchase these locally rather than to import them. Where equipment is purchased from different sources it is usually better to have one party, preferably the main supplier, install all the production equipment.

(b) Automation in manufacturing processes leads to rapid technological advances and the purchaser should be put in a position to profit from these. Given that the purchaser's country, if it is a developing one, may lack a tradition in industry, the purchaser may require the supplier's assistance in this regard. To this end a provision should be included in the contract requiring the supplier to keep the purchaser informed of any technological changes and enabling the purchaser to alter his/her order for equipment before some date defined by reference to the delivery schedule. Alternatively, the supplier should be required to warrant that the production equipment will incorporate the latest proven technology as of a certain date.

37. Technical Information

(a) In order to be in a position to plan the construction work the purchaser must have available at an early stage all the technical information relating to the plant. The contract must make specific provision for the early delivery of this data.

(b) The purchaser must ensure that the contract requires the supplier to furnish the former with all the instructions, drawings and information necessary to enable the purchaser to maintain and repair the plant. Indeed, the purchaser should consider including in the contract a provision entitling the purchaser (with his/her employees) to attend during the manufacture of the plant at the supplier's factory or wherever the machinery is being produced so as to familiarize him/herself with the machinery. This latter provision could be coupled with one requiring the testing of the plant in the purchaser's presence.

38. Quality

(a) Paragraph 21 outlines the means by which the requirement of quality in goods can be dealt with in a contract. The same principles apply to contracts for the supply of plant. In respect of plant, however, an additional means by which the quality of goods and services to be provided can be describled is by pre-specifing the results these are to achieve in terms of the quantity and quality of the products to be assembled or manufactured with the production equipment.

(b) There may be an additional requirement to that of quality simply. Production equipment is only one element in the construction of a factory and it must conform with the other elements involved. Thus it may be necessary to stipulate in the contract that the production equipment will meet the specifications and production standards required of it by other aspects of the construction. This is more particularly the case if the purchaser has entered a licensing agreement.

(c) If the supplier is to erect and install plant, both that supplied by him/her and by third parties, then the warranties of quality must be made to apply not only to the production equipment delivered by the supplier but also to the erection and installation of all the plant.

(d) Where the purchaser has engaged an architect/engineer to supervise and co-ordinate the construction he/she has the opportunity of double-checking the plant and its installation in so far as the engineer/architect can be given the task of testing and inspecting these. Payment of the purchase price can be made conditional upon the certificate of the architect/engineer indicating the supplier's compliance with the contract. (See also UNCITRAL document A/CN.9/WG.V/WP.13/Add.1 "Scope and Quality of Works".)

39. Delay in Performance

The remarks made in paragraph 23 and paragraph 18 apply to the supply of production equipment. (See also UNICTRAL document A/CN.9/WG.V/WP.11/Add 3. "Failure to Perform" and A/CN.9/WG.V/WP.7/Add.3 "Maintenance and Spare Parts.)

40. After Sales Service

The comments made at paragraph 22 apply.

E. CONTRACT FOR THE INITIAL MANAGEMENT OF WORKS FOR THE ASSEMBLY OR MANUFACTURE OF AGRICULTURAL MACHINERY

41. Scope of services

(a) The tasks involved in organizing and putting into operation industrial works are numerous and varied; they include the establishment of management systems, the organization of procurement and supply, the putting into operation of stock management procedures, the organization of production itself, the planning of personnel requirements and the latter's training, the drawing of instructions and operation procedures and the planning and carrying out of experiments to achieve the optimal use of the production equipment. The more skillfully the initial management is carried out, the more efficient will be the later operation of the factory.

(b) Purchasers who lack experience often engage an operations manager, be he/she the supplier of the plant, the industrial engineer/architect, the licensor or some other person, to assist in the initial operation of the works. The operation's manager can be engaged to advise and instruct the purchaser and his/her employees in the running of the works only, leaving the purchaser with direct responsibility for their operation. Alternatively, the operations manager's function can be to take complete responsibility for the management of the factory for a specified period followed by a phased transfer of responsibility to the purchaser. Whichever division of responsibilities is chosen - whether the operations manager is to be directly or indirectly answerable for the operation of the factory - this must be specified in the contract.

(c) It is beyond the scope of these Guidelines to describe the services offered by operations managers (the reader should consult ECE document "Guide on Drawing Up International Contracts for Services Relating to Maintenance, Repair and Operation of Industrial and Other Works" Trade/GE. 1/R.32 for a description of these). Suffice it to say that these range from actual technical management to technical assistance and training. The purchaser, in the light of the skill and experience available to him/her, can choose to employ an operations manager to provide technical management with direct responsibility in those areas in which the purchaser has no expertise, to render technical assistance (leaving the purchaser with direct responsibility) in those sectors of works management in which the purchaser has some experience and/or to provide the training of the purchaser's employees in certain or all technical and managerial matters.

42. Transfer of Responsibility

Where the operations manager is directly responsible for the operation of the factory or any aspect of its management, that is to say, where the operations manager is supplying technical management, it is essential that the contract specify the method and time scale by which the operation manager's responsibilities are to be transferred to the purchaser. In this regard, particular attention must be paid to the phasing of the training to be provided so as to ensure that the purchaser and his/her employees are adequately instructed when they come to take over the operation of the factory.

43. Information

(a) The purpose in engaging an operations manager is not only to have him/her exercise his/her skill and experience in the initial management of the works but also to obtain from him/her the information necessary to enable the purchaser to manage the factory and to operate it efficiently. That information should, of course, pass to the purchaser and his/her employees in the course of the initial management to ensure that the purchaser will be able to carry on the operation of the works once he/she becomes responsible for it.

(b) To ensure the transfer of the information the purchaser should consider the inclusion of a clause in the contract requiring the operations manager to prepare and deliver a plant organization study within an agreed time limit. Such a study could, **inter alia**, describe the optimal managerial, administrative and financial systems to be employed, provide a detailed study of the production capacity of the works and how this can be maximized, set out the methods of achieving and maintaining quality, detail the possible modifications to be made to the products manufactured, make recommendations about the recruitment and training of personnel and advise on the means of enlarging and developing the operation.

44. Standards (Quality)

(a) The remarks made at paragraph 34 apply here too.

(b) Quality, however, can also be defined in terms of the result. An operations management contract sometimes requires the supplier of those services to carry out his/her obligations in such a manner as will achieve a certain rate of productivity in the works. Where such a provision is included in the contract the operations manager usually requires an opportunity to review the design and construction plans of the factory. Accordingly, if the purchaser wishes to include a provision in his/her contract with the operations manager requiring the achievement of a specified production level, he/she should negotiate the latter contract sufficiently early to allow the operations manager to be involved in the design and construction plan of the factory.

45. Personnel

(a) The contract should specify the staff which the operations manager is to provide to carry out his/her obligations under the contract.

(b) If the operations manager is engaged in the training of the purchaser's employees, then the various categories of the purchaser's staff to receive instruction should be specified in the contract.

(c) Depending on whether the operations manager is to act in an advisory capacity or is to be directly responsible for the operation of the works, he/she will need to have more or less authority over the purchaser's employees. The contract should make clear the limits of the operations manager's right to direct the purchaser's staff.

46. Price

The usual methods of calculating an operations manager's fee are those applicable in the case of an industrial architect/engineer (see paragraph 32 above).

F. LICENSING AGREEMENT AND CONTRACT FOR THE TRANSFER OF KNOW-HOW FOR THE ASSEMBLY OR MANUFACTURE OF AGRICULTURAL MACHINERY

47. The contract under review here is particularly complex, not only by reason of the legal questions involved but also because of the different natures of the elements concerned - patent and trademark rights and the communication of know-how and technology. Only a few aspects of the contract can be mentioned here and then in general terms. A prospective purchaser from a developing country should consult the WIPO "Licensing Guide for Developing Countries" to obtain an overall view of the items to be included in the contract and for a detailed description of the clauses which can be included in the licensing agreement and contract for the transfer of know-how. (As regards the latter, see also "Guide for Use in Drawing up Contracts Relating to the International Transfer of Know-how in the Engineering Industry", ECE/Trade/222/Rev.1).

48. Scope of the Contract

(a) Should a purchaser desire to manufacture specific products or machinery incorporating a particular technology he/she will need to acquire an industrial property licence. A purchaser from a country without a tradition in industry may also need to obtain assembly or manufacturing know-how. An **industrial property licence** gives the purchaser permission to do certain acts governed by the exclusive rights conferred by law on the holder of a patent of invention, utility model or trademark. The supply of **know-how** is the communication - effected in writing, orally or by demonstration and training - of technical information and skills concerning the use and application of industrial techniques.

(b) The contract assigning such rights and providing for the transfer of know-how should define the aspects of the assembly or manufacture of the products in respect of which the supplier is to grant a licence and transfer know-how. The methods by which the technical information and industrial property rights are to be transferred in each such aspect must be particularized in the contract.

49. Limitations

The transferor of industrial property rights and know-how is entitled - subject to the agreement of the parties - to limit the use to which these can be put by the purchaser. As the value of know-how lies in it or certain aspects of it being secret, the transferor of know-how may require the purchaser not **to disclose** the **information** he/she is acquiring to third parties. Furthermore, both as regards know-how and all other industrial property rights, the transferor of these can limit the purchaser's use of them:

(i) as regards the **territory** in which he/she may exploit them;

(ii) in respect of the **markets** in which he/she can sell the products manufactured using the know-how and industrial property rights;

(iii) in terms of the **time** during which the purchaser is entitled to exploit the know-how and industrial property rights;

(iv) as regards the **fields of activity** in which they can be used.

In addition, the transferor may require the purchaser's undertaking **not to purchase** from **another** source **technology** which competes with that supplied by him/her. For his/her part, the purchaser can require the transferor to undertake not to provide the technology or a licence to a third party operating in a the purchaser's proposed sales' area. Whatever the constraints which the parties agree to impose on one another, these must be detailed in the contract.

50. Developments and Improvements

To be valuable technology must be up to date. In view of the rapidity of technical progress, the purchaser must ensure that the contract takes account of the developments likely to occur in the technology. To that end a provision can be included in the contract stipulating that any improvements or developments in the know-how or the subject matter of any relevant patent or trademark coming into either party's hands will be communicated and rights granted to the other party on specified terms. It is usual for such a clause to exclude from its scope information and rights in developments and improvements which, when incorporated into the products, alter them substantially. Rather, in the latter case, the contract often provides for the purchase of such improvements and developments by one party from the other at a favourable price. (See also paragraph 58 below).

51. Marketing and After Sales Service

When the purchaser does not have available locally expertise in marketing, as is often the position of a purchaser from a developing country, he/she can sometimes make use of his/her close identification with the transferor - an identification which is particularily strong where the parties share a trademark or where the products are described as assembled or manufactured under the transferor's licence. This identification of the parties permits them to pursue jointly various measures - e.g. advertising - to promote the sale of the agricultural machinery in question. If the purchaser's production capacity is anticipated to exceed local demand than he/she should consider including in the contract a provision enabling him/her to use the distribution channels and after sales services developed abroad by the transferor.

52. Warranties and Conditions

(a) The warranties and conditions to be included in the contract for the transfer of industrial property rights and know-how are so varied and numerous that only the most fundamental can be mentioned here (documents such as the WIPO "Licensing Guide for Developing Countries" describe the warranties and conditions whose inclusion should be considered).

(b) The novice purchaser of a technology is not in a position to know in any detail the information, instructions, assistance and industrial property rights necessary to enable him/her to assemble or manufacture certain items of agricultural machinery. His/her weak position in this regard is compounded by the secrecy in which know-how is held. His/her lack of experience and the secrecy mentioned make the purchaser entirely reliant on the transferor's estimate of the purchaser's requirements. The contract must therefore include, amongst the other warranties and conditions, one stipulating that the information to be transferred and industrial property rights assigned will be sufficient to enable the purchaser to assemble or manufacture the products to the same standard of quality and with the same efficiency as the transferor.

53. Price

(a) Payment for industrial property rights and know-how can be made by way of a lump sum, fees or royalties or by a combination of these.

(b) A lump sum may be payable either in one single amount or by instalments agreed upon in the contract, these last at a fixed rate or at a decreasing rate. A purchaser from a developing country will probably have cash flow and currency difficulties. The payment of a lump sum is therefore unlikely to appeal to him/her. If such a lump sum payment is required to be made, then it may be beneficial to the purchaser to limit the amount - leaving the balance of the price to be paid in royalties - and to have any lump sum payable staged over a number of instalments.

(c) **Royalties** are recurring payments, calculated after the grant of the licence and transfer of know-how, the amounts of which are determined by reference to the extent of the exploitation of the know-how and licence. In order to establish the degree of the exploitation of the know-how and licence (so as to be able to calculate the royalties), reference must be made either to the volume of production, the selling prices of the products or the purchaser's profits.

(i) When royalties are payable in respect of each product manufactured, it is usual that the amount of the royalty payable be expressed as a fixed sum, not as a percentage of the cost of manufacture or the selling price. Due to financial constraints a purchaser from a developing country is usually not in a position to make payments in advance of the return to him/her of his/her initial investment in the acquisition of the works. Thus, the payment of royalties on the production of agricultural machinery, before the purchaser has had an opportunity of selling the products, may be an unsuitable method for him/her to employ.

(ii) Royalties related to sales are paid only when each product is actually sold. Where royalties are linked to sales the contract must provide the criterion of calculation to be used to arrive at the "selling price", a percentage of which is payable as a royalty. The "selling price" can be the gross selling price, the net selling price or the fair market price of each product. The use of the gross selling price as the basis of calculating royalties does not favour the purchaser - particularily if the supplier's contribution to the project as a whole is not great - as it includes not only those parts of the products manufactured under the licence or with the aid of the know-how transferred but also those parts produced with technology and skills acquired by the purchaser from other sources. The more advantageous method of calculation for the purchaser is based on the net selling price, that is to say, the selling price less the cost or value of certain items unrelated to the licence and know-how in question. This last method of payment of royalties most accurately reflects the contribution of the supplier to the manufacture of the products. To ensure the payment of maximum royalties even in the event that the purchaser sells the products he/she manufactures or assembles at an unreasonably low price, contracts sometimes provide that the "selling price" is to be deemed the "fair market price" as defined in the contract.

(iii) Where royalties are ascertainable by reference to the purchaser's profits, no royalty payment is due until the enterprise begins to make a profit from sales of the agricultural machinery produced. This method of calculating royalties is usually the most favourable to the purchaser (with the system of calculating royalties on the net selling price running second favourite). However, the transfor may be reluctant to accept such a method of calculation unless he/she is reasonably convinced of the likelihood of early profits to the purchaser's operation. Such a conviction does not usually come about unless the transferor has some involvement in the initial management of the works.

(d) The **fees** payable for technical assistance may be included in the lump sum and /or royalties payable. If they are not, then such fees are likely to be payable on the basis of one of the methods described in paragraph 33 above.

PART III

This Part outlines some of the clauses usually included in international contracts.

54. Recitals

Contracts often contain a preamble consisting of recitals which describe the business background of the parties, explain the reasons for the agreement and state the purposes and objectives of the contract. As circumstances require, the recitals can also contain representations as to the expertise of the supplier, the inexperience of the purchaser, the ownership of industrial property rights etc.. The recitals serve to describe, if very briefly, the setting and conditions in which the agreement has been concluded. A preamble may - depending on the legal system considering it - assist in interpreting the intentions of the parties as to all or part of the contract in any later dispute. Recitals can be beneficial and should be included in the contract.

55. Definitions

The definition at the outset of the contract of certain phrases or descriptions which appear frequently in the contract enables an abbreviation to one or more words of those phrases and descriptions so as to facilitate an understanding of the substantive clauses of the contract. Such definitions serve not only to abbreviate but also make for precision of language, something particularily desirable in international contracts where language barriers and differences in the legal systems governing the parties may of themselves cause misunderstandings.

56. Substantive Transaction

It is as well to include in a contract a general clause describing the "give and take" of the agreement. Such a clause is not intended to be exhaustive in dealing with the goods or services to be supplied on the one hand or the purchase price or other benefits passing to the supplier on the other; its purpose is to establish a fair exchange between the parties.

57. Entry into Force, Commencement and Completion

It is important to specify in the contract the date upon which it is to enter into force, that is to say, the date upon which it is to become operative and binding on the parties. In the absence of a provision in that regard, it is usually deemed that the contract was intended to come into force on its signature by the parties. If the contract's entry into force is to be dependant upon the fulfillment of certain conditions, these must be specified in the contract. The date upon which the supplier or transferor is to commence performance of the contract, the term during which such performance is to be carried out and the date upon which it is to be completed or, where such dates are dependant upon the fulfillment of certain conditions, those conditions, must be stated in the contract. The date upon which the purchaser is to deliver the consideration - the purchase price or other benefits - is normally specified in a clause dealing with all the aspects of payment.

58. Ownership of Documentation

It is usual for contracts to provide that the party supplying documentation or information is to retain ownership of that documentation or information save to the extent that it is otherwise stipulated in the contract. In this regard, however, the purchaser should ensure that the contract does, in fact, secure to him/her the ownership of all the

specifications, instructions, drawings and other information relating to any improvements or developments, including adaptations, developed by the purchaser in the products to be manufactured or technology to be transferred.

59. Standards

(a) As has been mentioned (see paragraph 16 above) a contract should couple provisions of general application with those of a detailed nature. In order to ensure a degree of quality in those aspects of the goods or services not specifically adverted to in the contract, the purchaser should seek to import to the contract some overall system of standards and quality.

(b) Many trades and professions have established codes of conduct and of standards. In addition, in some countries the suppliers of certain goods and services are required to adhere to standards established by law. The purchaser should consider defining as the overall standards to be employed in the performance of the contract those of the supplier's trade or professional association or those defined in the legislation of the supplier's country if these are more stringent than those applicable in the purchaser's country.

(c) Whatever system of standards or quality is chosen - one provided by the legislature in the purchaser's country or by an association or the legislature in the supplier's country - it is important that standards of general application be specified in the contract as applicable to the goods to be supplied or services to be rendered.

60. Price

(a) Payment for goods and/or services can be made in cash or in goods or services or both. Where payment is made in goods these usually consist of raw materials or the completed products manufactured with the aid of the goods or services provided by the supplier.

(b) In addition to the usual provisions regarding payment by the purchaser - the amount, the time for payment and the interest rate (if any) on late payments - international contracts must also take into account such matters as the currency in which cash payment are to be made.

61. Assignment

The purchaser should consider how far he/she desires to limit the assignment by the supplier of the whole or part of the contract. Should such an assignment take place the original supplier will be relieved of his/her responsibility to the purchaser leaving the latter to look to the assignee for such performance. It is therefore usual to provide in the contract that the supplier may not assign the contract in whole or in part without the written consent of the purchaser. If the contract stipulates that the supplier must, when seeking the purchaser's consent, name the proposed assignee, then the purchaser will have an opportunity of investigating the latter before giving or refusing his/her consent.

62. Sub-Contracting

Where a contract or part of it is sub-contracted by a supplier, the latter remains liable to the purchaser for the services or goods provided by the sub-contractor. Accordingly, the purchaser is not so much concerned with the principle of whether or not the supplier should be permitted to sub-contract as with the conditions to be attached to this. The issue in clauses relating to sub-contracting is usually in whom the choice of sub-contractor is to lie. In the conditions in which contracts between a purchaser from a developing country and a supplier from a developed country are concluded the best option is, perhaps, that of inviting the supplier to propose sub-contractors subject to certain conditions which frame the manner in which the choice is to be made

and subject also to the purchaser's veto. Thus, the contract can provide that, in drawing a list of potential sub-contractors for the purchaser's approval the supplier must take into consideration contractors in the purchaser's country and must present the purchaser with an evaluation of the relative merits of the sub-contractors he/she nominates.

63. Security of Performance

It is quite common for purchasers to seek to ensure the supplier's performance of his/her obligations under the contract by withholding as security that portion of the consideration payable to the supplier which is equivalent to all or a part of the liquidated damages which may become due under the contract until the expiry of the guarantee. An alternative or additional form of security sometimes adopted is that of requiring the supplier to furnish a conditional letter of credit or other bank guarantee in the amount of all or a part of the maximum liquidated damages which may become due from the supplier under the contract. Where damages and not liquidated damages are the sanction against the supplier's non-performance then the amount withheld or payable on foot of the bank guarantee should be a sum which would constitute realistic compensation to the purchaser. (See also UNCITRAL document A/CN.9/WG.V/WP.13/Add.6 "Security for Performance".)

64. Failure to Perform (Breach of Contract)

(a) International contracts should provide what are to be the consequences of a failure of the parties to perform their contractual obligations even if the law intended to be applicable to the contract specifies such consequenses.

(b) Contracts usually provide a number of escalating remedies to the purchaser for the supplier's failure to perform, the choice of remedy being dependant upon the degree of significance attached to a particular failure. Thus in cases of delay the supplier may be required to pay damages or liquidated damages (or penalties) initially but if the delay continues beyond a certain period, the purchaser may be entitled to terminate the contract. Similarly, where the supplier fulfills his/her obligations in a defective manner the purchaser may be entitled to require the supplier to rectify the defects. If such rectification is not carried out the contract usually empowers the purchaser to terminate the contract and to receive damages or, as in the case of a failure to attain certain production and quality parameters, liquidated damages, from the supplier.

(c) If the purchaser delays in the performance of his/her obligations - i.e. the payment of the purchase price - the supplier usually has the right to be compensated for any losses sustained by him/her - e.g. the receipt of interest on late payments - and, ultimately, if the purchaser fails to perform his/her obligations, the supplier may be entitled to terminate the contract. (See also UNCITRAL document A/CN.9/WG.V/WP.11/Add.3 "Failure to Perform").

65. Force Majeure

Events which are outside the control of the parties may occur or circumstances similarily outside the parties' control may change so as to delay or render impossible performance of the contract or increase the risks or expenses involved in such performance. Contracts usually contain a clause stipulating that a party is not liable for his/her failure to perform any of his/her obligations under the contract if that failure is due to a change of circumstances or the occurence of an event -

(i) coming about after the signing of the contract,

(ii) which could not reasonably have been foreseen at the date of signing of the contract, and

(iii) which is beyond the control of the party claiming relief under that clause.

Should the parties wish to define or describe the circumstances or events whose alteration or occurence will entitle the affected party to relief, it would perhaps be wise to include a provision in more general terms and to refer to the list of events and occurences as illustrative and not exhaustive (see paragraph 16 above). The **force majeure** clause can also stipulate a procedure to be adopted should one of the parties believe that circumstances or events such as those described are about to alter or occur. The ultimate stage of that procedure could be the employment of the machinery for the settlement of disputes provided in the contract (see paragraph 66 below). The use of such an anticipatory procedure may enable the parties to avoid later disruptive disputes.

66. Termination

There may be circumstances in addition to those mentioned above at paragraphs 63 and 64 in which the parties may agree to allow the unilateral suspension or termination of the contract, e.g. for the convenience of the purchaser. The parties should stipulate specific circumstances or reasons which will enable such suspension or termination and the procedure to be adopted. It is usual for contracts to provide that where some item has been made a condition (as opposed to a warranty) of the contract that the non-fulfillment of that condition will entitle the effected party to terminate the contract. It must be noted that the termination of a contract does not relieve the offending party of his/her liability to the other in damages. (See also UNCITRAL document A/CN.9/WG.V/WP.9/Add.5 "Termination".)

67. Settlement of Disputes

(a) As has been said, the parties rights and liabilities should be determined in the contract so far as possible so as to eliminate areas of potential dispute. At the time the contract is concluded, however, it is not possible to foresee all the difficulties which may arise in giving effect to the contract. Where later differences between the parties cannot be resolved by reference to the contract or by negotiation the parties must resort to external procedures. The contract should make due provision for these. There are a number of procedures commonly used.

(b) It is now not unusual for contracts of a specialized nature - e.g. for the transfer of technology - and contracts for the construction of works to provide for the appointment of an **independent expert** to whom disputes can be referred quickly and informally. The opinion or recommendation given by such an expert in disputes referred to him/her can facilitate an early resolution of those disputes.

(c) The parties to a contract are both interested in resolving their disputes without recourse to lengthy and costly arbitral or judical proceedings. They may, therefore, agree to institute a **conciliation** procedure to be implemented before any proceedings can be commenced. The aim of conciliation is to reach an amicable settlement of the dispute with the aid of an intermediary. The latter does not adjudicate between the parties but, rather, assists the negotiations by giving impartial advice. If the parties wish to provide for such a conciliation procedure they can either detail it in the contract or adopt a procedure designed by a third party, e.g. the UNCITRAL Conciliation Rules.

(d) International contracts today almost invariably contain a clause providing for **arbitration** as the forum for ultimately settling disputes. One reason why arbitration is favoured over judical proceedings is because, in consequence of a number of international conventions, arbitral awards can be more easily enforced than judical decisions.

Particular attention must be paid to the wording of an arbitration clause. If arbitration between the parties becomes necessary this is made easier if the arbitration procedure is provided in the contract either by it being detailed in the arbitration clause or by importing to the contract the rules of arbitration established by an international body, e.g. UNCITRAL, International Chamber of Commerce etc..

(e) As an alternative to the submission of their disputes to arbitration the parties may choose to have these dealt with in proceedings instituted before a judicial tribunal. If such is the parties' choice, the contract should state the country whose Courts are to have juristiction in disputes between the parties. It is usually better to choose a country with a real connection with the contract. There are a number of considerations to be taken into account in making that choice. For example, the costs of any litigation will be reduced for the purchaser if the Courts in his/her country are designated those with juristiction. On the other hand, the purchaser's position may be strengthened if proceedings are brought in the supplier's country as the supplier may find any publicity attached to such proceedings embarrassing.

(f) Some contracts for the construction of industrial works provide that the supervising engineer/architect shall adjudicate on certain issues between the parties (see paragraph 32 above). It is usual to provide that the decision of the architect/engineer, where such authority is vested in him, will be subject to an appeal by either party to arbitration or judical proceedings.

68. Applicable Law

Despite the parties' efforts in clarifying their rights and liabilities in the contract, there may be matters not dealt with which require a legal framework within which they can be adjudicated upon. The contract should specify the state whose legal system is to apply to the contract. In theory the parties are free to choose whatever legal system they wish. In practice, however, there are a number of limitations, e.g. some legal systems do not admit the application of another if the former has juristiction over one of the parties or over the contract, some contracts requiring government approval will be refused such approval if they contain a provision making applicable the law of another country. Customarily, either the law of the purchaser or of the supplier's country or, if different, the country in which the contract is to be performed is chosen as the applicable law. It is in the purchaser's interest to have nominated as the legal system applicable one which has developed consumer legislation. Accordingly, the purchaser should investigate the extent to which his/her interests are protected under different legal systems and seek to have that which affords him/her the best protection made applicable.

69. Language

If the contract or any of its auxillary documents are drawn up in more than one language, the contract should state which is the ruling one. Furthermore, the contract should specify the language to be used in its implementation as regard correspondance and the giving of instructions.

1. The majority of the UNCITRAL (United Nations Commission on International Trade Law) documents referred to in these Guidelines form part of the Draft Guide on Drawing Up Contracts for Construction of Industrial Works. The Chapters mentioned are:

"Choice of Contracting Approach"	A/CN.9/WG.V/WP.15/Add.8
"Damages"	A/CN.9/WG.V/WP.11/Add.4
"Scope and Quality of Works"	A/CN.9/WG.V/WP.13/Add.1
"Failure to Perform"	A/CN.9/WG.V/WP.11/Add.3
"Security for Performance"	A/CN.9/WG.V/WP.13/Add.6
"Termination"	A/CN.9/WG.V/WP. 9/Add.5

In addition, document A/CN.9/WG.V/WP.7/Add.3 "Maintenance and Spare Parts"[1/] is referred to in these Guidelines.

2. The ECE (Economic Commission for Europe) Guides referred to in these Guidelines are:

"Guide on Drawing Up Contracts for Large Industrial Works"	ECE/Trade/117
"Guide on Drawing Up International Contracts on Consulting Engineering, Including Some Related Aspects of Technical Assistance"	ECE/Trade/145
"Guide for Use in Drawing Up Contracts Relating to the International Transfer of Know-How in the Engineering Industry"	ECE/Trade/222/Rev.1
"Guide on Drawing Up International Contracts for Services Relating to Maintenance, Repair and Operation of Industrial and Other Works"[2/]	(ECE)Trade/GE.1/R.32

3. The "Licensing Guide for Developing Countries" is a United Nations, World Intellectual Property Organization document.

4. The Final Act of the United Nations Conference on Contracts for the International Sale of Goods (No.A/Conf.97/18) is also mentioned in the Guidelines.

These documents are available from the United Nations, Sales Section, New York or Geneva.

5. The document "Legal Aspects of Industrial Training" is available from the United Nations Industrial Development Organization, Sales Section, Vienna.

1/ A new Chapter of the UNCITRAL Draft Guide entitled "Supplies of Spare Parts and Services After Completion of the Works" is to be published shortly.

2/ For the present, this document is designated "Restricted".